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RUEHML/AMEMBASSY MANILA 3085
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C O N F I D E N T I A L SECTION 01 OF 06 ISLAMABAD 003590

SIPDIS

REFS: A. ISLAMABAD 03493

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TAGS: ECON EFIN EINV ETRD ELAB PGOV PREL PK
SUBJECT: IDEAS FOR USG ECONOMIC ASSISTANCE FOR PAKISTAN

Classified By: Anne W. Patterson for reasons 1.4 (b), (d).

¶1. (C) SUMMARY. As the Government of Pakistan (GOP) and the IMF edge closer to finalizing an agreement, additional donor assistance will likely be sought to bolster the IMF package. Post recommends consideration of the following economic options to support the democratically-elected Government of Pakistan (GOP). These options represent targeted approaches to complement the IMF agreement, not replace it. To state the obvious, Pakistan is an important ally of the USG and an economically secure Pakistan is necessary to ensure regional stability. End SUMMARY.

¶2. (C) Pakistan now has a civilian democratic government that is pro-American and determinedly anti-terrorist. It has forged a new political consensus against extremism and is "doing more" in the war on terror. Under new leadership, the Pakistani Army and Frontier Corps are actively fighting and making progress in defeating militant extremists in Bajaur and Swat, although with considerable civilian casualties. They are killing militants, reclaiming territory, and plan to continue their military campaign in the Waziristans. U.S. programs to train and equip Pakistani security forces are moving forward after long delays, and our cooperation is improving. We are now coordinating military actions on both sides of the Pak-Afghan border, and we are slowly delivering on employment and development projects to make the tribal areas less hospitable to extremism. The U.S. recently has had significant success in eliminating key al Qaida and Taliban leaders who have been operating in Pakistan. In other words, we are making some progress on our security agenda, but all of this progress is threatened by the possibility of economic collapse. The young civilian government is under enormous pressure from rising food and electricity prices and rolling power blackouts that threaten its popular political base. Unless the international community is able to help them deliver basic services, we risk losing recent gains in the battle against extremism.

¶3. (C) Pakistan is in the final stages of negotiating a Stand-By Arrangement with the International Monetary Fund (IMF). This IMF program will provide significant resources to meet the immediate balance of payments obligations of Pakistan. It will also articulate the policy actions and results necessary to make Pakistan's economy sustainable again. In addition to IMF resources, however, Pakistan will require substantial support from the donor community, especially to provide programs to protect the poor during the short term.

¶4. (C) The following are recommendations by Post for consideration by Deputies and Principals in deciding on possible USG economic assistance for Pakistan. The options are not/not mutually exclusive of one another and are not/not in a rank order. Post believes the USG needs to revisit its strategy with regard to food aid (GSM-102 and PL-480) to Pakistan. On November 10, militants hijacked 13 trucks, 11 of which were reportedly carrying 441 tons of wheat for the World Food Program (WFP) to distribute, aggravating the food shortage.

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GSM 102
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¶5. (C) Pakistan faces a wheat shortage as it currently holds 3 million tons in wheat stocks which is only sufficient to meet domestic consumption needs through January 2009. It will not harvest its next wheat crop until April/May 2009; therefore it needs to import 1.75 million tons of wheat in order to meet demand. The GSM-102 program helps ensure that credit is available to finance commercial exports of U.S. agricultural products by providing competitive credit terms to buyers. By reducing the financial risk to U.S. lenders, the GSM-102 program encourages exports to countries, such as Pakistan, where financing (and therefore sales) might not be available without the program.

¶6. (C) Advantages: Post believes that the approval of a USD 450 million U.S. Department of Agriculture (USDA) GSM-102 credit guarantee program for Pakistan in FY 2009 would support sales of U.S wheat and enhance food security throughout the country (reftel A).

To meet the country's consumption needs until it harvests the next crop, the government must purchase an additional 750,000 tons of red wheat and 1 million tons of white wheat, worth approximately USD 450 million. This will also provide a vote of confidence in the GOP.

¶7. (C) Disadvantages: The possibility exists that the GOP may default on its debt. This happened before between 1998 and 2002.

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PL-480
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¶8. (C) PL 480 has three titles, and each title has a specific objective and provides assistance to countries at a particular level of economic development. Title I of PL 480 is administered by USDA, and Titles II and III are administered by USAID.

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PL-480 - TITLE I - FOOD FOR PROGRESS
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¶9. (C) PL 480, Title I - Trade and Development Assistance provides government to government sales of U.S. agricultural commodities to developing countries on credit or grant terms. Depending on the agreement, commodities provided under the program may be sold in the recipient country and the proceeds used to support agricultural, economic, or infrastructure development projects. The Food for Progress Act authorizes the use of Title I resources to assist emerging democracies.

¶10. (C) Currently, Post is in the final stages of negotiating a Food for Progress program for 50,000 tons of U.S. wheat. When it was originally negotiated, the price of 50,000 tons of wheat was USD 24 million. Since then, the price of wheat has dropped so that 50,000 tons of wheat now amounts to USD 7.95 million. Assuming that USDA budgets for agreements in dollar amounts rather than tonnage, there should be a surplus of USD 16.5 million which would purchase another 100,000 tons of wheat at current world prices. Post recommends using the fully allocated dollar amount to purchase as much as possible wheat under current world prices.

¶11. (C) Advantages: Agreements under the Title I credit program may provide repayment terms of up to 30 years with a grace period of up to 5 years.

¶12. (C) Disadvantages: Reports indicate that all other funds under Title I have been fully committed.

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PL-480 - TITLE II
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¶13. (C) PL 480, Title II - Food for Peace is administered by USAID and involves the donation of U.S. agricultural commodities to meet emergency and non-emergency food needs in other countries. Agricultural commodities donated by the USG are traditionally provided through the WFP or private volunteer organizations. Prior to the Pakistani Prime Minister's visit to Washington in July, Post recommended PL-480, Title II assistance for Pakistan but there were higher priority countries. Post reprogrammed USD 8.5 million USAID Economic Support Funds to sponsor a school feeding program in NWFP and Balochistan.

¶14. (C) Advantages: Based on the November 10 PCC, Post was informed that concessional food supplies under PL-480, Title II would be preferable to GSM credits to assist in meeting the GOP's immediate food needs without incurring any long term debt. We agree. Pakistan is eligible for Title II assistance as the GOP does not have sufficient resources to provide food security to the Pakistani population.

¶15. (C) Disadvantages: The process may not be quick enough to help Pakistan's short term needs unless an emergency program is requested. Unlike GSM-102, these are grants and donations which do not build any capacity on the GOP side. Also, the amounts of the

donations/grants will likely not be as large as they would be under a commercial agreement.

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PL-480 - TITLE III
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¶16. (C) PL-480, Title III - Food for Development provides government to government grants to support long-term growth in the least developed countries. Donated commodities are sold in the recipient country, and the revenue generated is used to support economic development programs.

¶17. (C) Advantages: Title III could be used if Post can justify that Pakistan meets the eligibility requirements. USAID currently has the capacity to provide food donations to Pakistan.

¶18. (C) Disadvantages: Pakistan needs to qualify as a "least developed country" under the Title III criteria. There is some concern as to whether or not Pakistan meets this threshold. USAID defines a least developed country as being either an extremely poverty stricken country (using criterion established by the International Bank for Reconstruction and Development for Civil Works Preferences) or a food deficit country. Pakistan appears to qualify as an extremely poverty stricken country because, according to 2007 World Bank data, Pakistan's per capital annual income was USD 870. To be eligible under the International Bank for Reconstruction and Development's Civil Works Preferences, a country's per capita annual income must be USD 935 or less. Pakistan does not count as a food deficit country using USAID guidelines.

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OPIC funding
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¶19. (C) OPIC assists U.S. companies by providing financing (from large structure finance to small business loans), political risk insurance, and investment funds in an effort to support U.S. foreign policy. OPIC has an active portfolio in Pakistan totaling more than USD 254 million. Post recommends a fresh review of OPIC pipeline projects in Pakistan and that additional OPIC funding be considered for Pakistan, particularly for alternative energy projects or public works housing projects. Post is aware of OPIC restrictions on projects utilizing heavy fuel but believes that several projects are

available through the Alternative Energy Development Board which will require private sector funding.

¶20. (C) Advantages: OPIC has a pipeline of more than USD 114 million in Pakistan in sectors such as housing and power, as well as construction. Currently, OPIC is supporting three investment funds capable of providing equity investment in renewable energy projects in Pakistan. More U.S. businesses would invest in Pakistan if they were afforded the political risk insurance that OPIC provides.

¶21. (C) Disadvantages: The nature of OPIC support is more reactive than proactive. U.S. businesses have to go to OPIC to ask for financing/insurance in order for OPIC to offer assistance. OPIC cannot create its own projects; therefore, OPIC support for projects in Pakistan is limited to whatever projects are submitted to it through its application process. In addition, OPIC has strict environmental guidelines, as well as a cap of USD 250 million per project.

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Millennium Challenge Corporation - Threshold Program
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¶22. (C) Pakistan is a low-income country (per capita income USD 870). It is not eligible for a full MCC compact, but may be a candidate for a threshold program which is substantially smaller but designed to facilitate future compact eligibility. MCC's selection criteria are retrospective and lag current circumstances, including the establishment of a democratic government. Given Pakistan's recent improvements in governance and democracy, Pakistan's indicators should be reconsidered during program selection. The Millennium Challenge Corporation (MCC) is based on the principle that aid is

most effective when it reinforces good governance, economic freedom, and investments in people. Before a country can become eligible to receive assistance, MCC looks at its performance on independent and transparent policy indicators against the country's peer group of either low income (annual per capita income below USD 1,785) or lower-middle income (per capita income USD 1,785-3,705) countries.

¶23. (C) Resources Available: For comparison, MCC selected Indonesia for a two-year, USD 55 million threshold program in 2007. In 2006, MCC selected the Philippines for a USD 21 million grant.

¶24. (C) Advantages: MCC programs reward good governance and promote a stakeholder decision-making process. They also present opportunities to demonstrate the USG's commitment to partner with Pakistan.

¶25. ((C) Disadvantages: The MCC Board will meet December 11, and does not plan to consider Pakistan as a partner country for FY09. Pakistan may be eligible for FY10 consideration next year. Pakistan currently does not meet the criteria of Investing in People (failing immunization rates, health expenditures, and girls' primary education completion) and fails all but one of the six Ruling Justly criteria, including the critical control of corruption measure. If Pakistan builds upon the substantial improvements in governance and democracy during the next year it may merit special consideration for a threshold program.

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Reconstruction Opportunity Zones (ROZs)
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¶26. (C) The current product list for ROZs could be expanded to include additional textile and apparel goods which will have a more substantial impact for Pakistan's manufacturing sector and thus lead to greater job creation and development in the short term in Pakistan's border areas.

¶27. (C) Resources Available: Under the current legislation, a defined list of textile and apparel products is included for duty free access to the U.S. market. However specific textile and apparel products, designated by 34 textile category codes, currently covered under the U.S.-China Safeguard Agreement are specifically excluded from the ROZ

legislation. When the ROZ legislation was originally drafted, almost two years ago, the exclusion of these products was perhaps warranted but the U.S.-China Safeguard Agreement is set to expire on December 31, 2008 and thus competition in these product categories will be unfettered.

¶28. (C) Advantages: Post believes that expanding the coverage of textile and apparel products presents the greatest opportunity to ensure success of the ROZs. Given the dramatic decrease in stability and security in the targeted ROZ areas during the two years of legislative delays, expanded coverage is warranted to provide an extra incentive to entice investors to establish new or expanded industries. If full product coverage cannot be included for textiles and apparel then Post recommends the inclusion of shirts and trousers for women and men (categories 338, 339, 347, 348, 647, 648) to ensure that the ROZs will have the desired impact and that the intentions behind this 2006 Presidential commitment can be fulfilled.

¶29. (C) Disadvantages: While legislation has been introduced in both the Senate and the House of Representatives with broad bi-partisan support and we hope to see movement in a lame duck session, it is likely that there will not be sufficient time to move the ROZ legislation through committees and onto the floor for a vote. As legislation is reintroduced in the new Congress, an expanded product list could be put forward by the Administration but may encounter resistance from traditional textile protectionists.

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Exchange Stabilization Fund
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¶30. (C) The Exchange Stabilization Fund of the United States Treasury could help Pakistan with immediate liquidity, such as bridging a gap

between IMF program agreement and actual receipt of funds. It was created and originally financed by the Gold Reserve Act of 1934 to contribute to exchange rate stability and counter disorderly conditions in the foreign exchange market. The Act gave exclusive authority to the Secretary of the Treasury to deal in gold, foreign exchange, securities, and instruments of credit, subject to the approval of the President. Past Congresses complained the Exchange Stabilization Fund should have Congressional oversight, so notification has significantly improved. The Exchange Stabilization Fund has a long history of credit operations beginning in the early years of its existence. While there is some apprehension about using the Exchange Stabilization Fund, this fund was used in Latin America throughout the 1990s. In 1995, a USD 20 billion loan (collateralized by oil revenue) proved instrumental in stabilizing the Mexican peso crisis. Treasury Secretary Paulson used the Exchange Stabilization Fund this year to guarantee U.S. money-market funds.

¶31. (C) Resources Available: As of September 30, 2008, the Exchange Stabilization Fund had USD 40 billion dollars in net capital.

¶32. (C) Advantages: The Exchange Stabilization Fund has the tremendous advantage of being a large, liquid pool of capital the Executive branch can rapidly deploy at its discretion. Historically it has been used for short-term financing during balance of payments problems.

¶33. (C) Disadvantages: The Exchange Stabilization Fund should be used to complement an IMF program not replace it. Conditionality is critical to adjustment, but should be multilateral.

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Direct Budget Support
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¶34. (C) Another option would be to provide direct budgetary support to the GOP similar to the previous funding which was given under the Shared Objectives program. As the GOP cuts programs in order to reduce its deficit, the USG could support some of the more important projects to ensure their continued success.

¶35. (C) Based on reports from the IMF negotiations, the IMF is

worried about the lack of social safety nets for the poor in Pakistan. Education and health care are traditionally under funded sectors in Pakistan. A new Pakistan People's Party program, the Benazir Income Support Program (septel), will need support and targets the most vulnerable females by giving 1,000 rupees (USD 12.30) per month.

¶36. (C) Advantages: This method is direct and would provide short term gains for the GOP. It would complement the IMF program and may offset some of the resulting political/ economic backlash of such a program.

¶37. (C) Disadvantages: If this is not monitored carefully, there is potential for graft and misuse of U.S. funds. Also, this method is more of a short term measure which may not address any long term policy issues.

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DoD 1207/1210 Funding
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¶38. (C) Section 1207 of the National Defense Authorization Act provides for the Department of Defense to transfer to the State Department up to USD 100 million in defense articles, services, training and other support to use for reconstruction, stabilization, and security activities in foreign countries. This assistance can be in the form of either services or funds. Last year projects ranging from USD 4 million to USD 25 million were approved in Somalia, Haiti, Nepal, and other countries.

¶39. (C) Advantages: Numerous options could be explored to come up with a justification for projects in Pakistan that would fall under reconstruction, stabilization and security activities.

¶40. (C) Disadvantages: The total allocation is only USD 100 million which has to be divided among various countries.

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Securitization of Remittances
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¶41. (C) Securitization of remittances is not a source of new financing, but a method to improve credit worthiness and reduce the cost of borrowing by mitigating foreign exchange and repayment risks. Under one sovereign securitization scheme, a newly formed trust issues credit enhanced Pakistani sovereign debt, remitters send money through a financial institution, the institution directs the foreign currency to the trust and pays remittance recipients in rupees, the government of Pakistan makes loan payments in rupees to the trust, and the trust pays debt holders in foreign currency. Between 1992 and 2006, the three major credit rating agencies have rated 400 transactions that securitize the "future-flow" of funds, totaling over USD 80 billion. Latin American issuers dominate the market, with Mexico alone accounting for roughly 30 percent. Nearly USD 1.8 billion in remittance secured debt has been issued, only 2 percent of all future-flow securitizations. In 1997, the Pakistan Telecommunications Company (PTC, 88 percent government owned) issued a USD 250 million future-flow bond backed by future telephone receivables. Despite Pakistan's sovereign debt rescheduling PTC remained current on its obligations.

¶42. (C) Resources Available: The USG could support securitization with technical assistance on legal structures, debt underwriting, public-private partnering, and technological opportunities (i.e. cell phone transfers).

¶43. (C) Advantages: Securitization can be perceived as a home-grown solution. Pakistan has the advantages of many citizens working abroad, in geographically diverse economies, and a stable financial sector. In most remittance schemes, remitters are unaware the funds they send home offer two benefits: resources to recipients and collateral for financing. Innovative schemes could reduce the cost to transfer, increase the convenience, and/or give remitters a sense of satisfaction through assisting Pakistan.

¶44. (C) Disadvantages: Securitization is practically difficult because remittances, to be collateral, would need to be directed through one (or a few) financial institutions which then place the foreign currency in trust and deliver rupees to recipients. Remittances, however, often flow through informal channels. Securitization also has relatively high transaction costs. Other remittance schemes have failed due to concerns over privacy, government intervention, higher fees, or less convenience. It is also unclear whether a securitization structure would sufficiently enhance Pakistan's sovereign rating to access capital markets.

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Comment
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¶45. (C) Comment: Post recommends consideration of these options. These recommendations for USG do not represent handouts but rather more targeted, sustainable approaches to assistance. With the imminent approval of an IMF plan, the USG can and should show its full support for the democratically-elected Government of Pakistan and its efforts to establish economic stability. By adopting this IMF plan, the GOP is demonstrating that it is taking the current economic crisis seriously. We need to help offset any negative effects of the IMF plan while reinforcing regional economic and social stability. End comment.

PATTERSON